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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 349

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

AMERICAN CHICLE COMPANY

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The original opinion of the Board of Tax Appeals (R. 10–16) is reported in 23 B.T.A. 221. A memorandum opinion (R. 22–23) accompanying an order of the Board denying the Commissioner's motion for reconsideration and modification of the decision is not reported. The opinion of the Circuit Court of Appeals (R. 28–30) is reported in 65 F. (2d) 454.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 15, 1933. (R. 30.) The petition for a writ of certiorari was filed August 15, 1933, and certiorari was granted October 9, 1933. (R. 30.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respondent acquired all the assets of another corporation and assumed its liabilities including its outstanding bonds. Did the respondent realize taxable income by the purchase from the public in subsequent years of a number of the bonds at prices less than their par or face value?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

> SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, * * *.
>
> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, busi-

nesses, commeree, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

The provisions of Sections 233 (a) and 213 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253 (U.S.C., Title 26, Sections 985 and 954), and the Revenue Act of 1926, c. 27, 44 Stat. 9 (U.S.C.App., Title 26, Sections 985 and 954), are the same as the provisions of the Revenue Act of 1921 set out above.

Regulations 62, promulgated under the Revenue Act of 1921:

ART. 545. *Sale and retirement of corporate bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

The provisions of Article 545 (1) of Regulations 65 and 69 promulgated under the Revenue Acts of 1924 and 1926 are the same as the above-quoted provisions of Article 545 (1) of Regulations 62.

STATEMENT

The facts material to the issue as they were stipulated and found by the Board of Tax Appeals (R. 11–13) may be summarized as follows:

In August, 1914, the respondent acquired all the assets of the Sen Sen Chiclet Company, a Maine corporation, and assumed the payment of its liabilities, among which were $2,425,000 par value of bonds then outstanding and unredeemed. The bonds had been issued by the Sen Sen Chiclet Company in 1909 of a total face value of $2,700,000, maturing May 14, 1929, with a sinking-fund clause providing that a deposit be made with the trustee of at least $50,000 per year to provide for the purchase of bonds submitted to the trustee in open bid by bondholders under the terms of the indenture. (R. 11.)

In 1922, the respondent purchased from the public $82,000 par value of Sen Sen Chiclet Company bonds for which it paid a total of $55,650.94, making a difference of $26,349.06 between the par value and the redemption price.[1] (R. 11.)

[1] The deficiencies in issue are for the taxable years 1924 and 1925. The amount of income for 1922 is involved in the computation of the amount of the statutory net loss for that year to be carried forward to the year 1924.

During the year 1924 the respondent purchased from the public $15,000 par value of these bonds and paid therefor $11,391, and the trustee of the sinking fund also purchased from the public $44,000 par value of the bonds, paying therefor $36,211.10, the difference between the par value of such bonds and the redemption price paid being the amount of $11,397.90. (R. 12.) During the year 1925 the respondent purchased $166,500 par value of the bonds from the public and paid therefor $152,016.81 and the trustee of the sinking fund likewise purchased from the public $35,000 par value of the bonds, and paid therefor $34,129.50, the difference between the par value of the bonds and the redemption prices paid therefor being $15,353.69. (R. 13.)

The Commissioner included the difference between the par value and the redemption price in the taxpayer's income for each of these years. (R. 11, 12, 13.) The Board of Tax Appeals held that these amounts did not constitute taxable income. (R. 13–14.)

Two other issues which are not now involved were presented for decision by the Board, namely, the proper treatment during the year 1924 of the amount by which the face value of certain of respondent's notes purchased for retirement during that year exceeded the purchase price and a question as to the right of the respondent to deduct as an expense the excess of the purchase price over the

issuing price plus the total deduction for the amortization of discount allowable to the date of purchase on other of its notes.

Upon rehearing granted at the instance of the Commissioner the present respondent conceded upon authority of *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, decided after the promulgation of the original opinion, that it realized gain upon the purchase of its own notes at less than the price at which they were issued. The Board declined to modify its prior decision with respect to the effect of the purchase of the Sen Sen Chiclet Company bonds. (R. 18–19.) Subsequently, a motion for reconsideration and modification of the decision filed by the Commissioner was denied. (R. 20–21.) The Circuit Court of Appeals affirmed the decision of the Board. (R. 28–30.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that the respondent realized no taxable gain or income by the purchase and retirement of the bonds at amounts less than their par value.

2. In affirming the order of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The petitioner contends that the principle underlying this Court's decision in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, is applicable without regard to the nature of the property acquired and governs

the instant case. When the respondent assumed the liability of the Sen Sen Chiclet Company's bonds it acquired assets presumably equal in value to the liabilities assumed. When the respondent purchased some of the bonds at less than face in subsequent years it made available assets previously offset by the obligation of the bonds. To the extent that the taxpayer's surplus was increased because of the reduction of the liability of the bonds, taxable income was realized.

There is no proper basis for the theory of the court below that no taxable gain could be realized until there was a disposal of the property originally acquired. Income may arise from the reduction of a liability, thus increasing net worth, as well as from an increase in value of the property subsequently realized by a sale or other disposition. Since the income tax laws are based upon the results of annual transactions there is no need to await the sale of the property before taxing the gain realized upon the extinguishment of an obligation incurred in acquiring the property. Here there were separate and independent transactions. In the first, the assets were acquired and their cost was definitely fixed when the respondent assumed the obligation of the bonds. The bonds were retired in subsequent years in a separate series of transactions between the respondent and persons other than the corporation from which the property was acquired. Such separate transactions gave rise to

taxable income in the years when they occurred. Since income may be derived by the receipt of property as well as cash, the difference in facts between the instant case and the *Kirby Lumber* case should not lead to a different result. The decision in *Commissioner* v. *Coastwise Transp. Corp.*, 62 F. (2d) 332 (C.C.A. 1st), supports the petitioner's position.

We believe that the decision of this Court in *Bowers* v. *Kerbaugh-Empire Co.*, 271 U.S. 170, was based on the fact that the whole of the property acquired had been lost, and that the subsequent favorable retirement was merely a diminution of the loss—a situation which does not exist here. The reasoning of the court below, followed to its logical conclusion, demonstrates the unsoundness of the decision as a practical matter under a system taxing annual gains.

ARGUMENT

I

PRELIMINARY STATEMENT

The regulations have consistently provided that where a corporation retires its bonds at less than face it realizes income to the extent of the excess of the issuing price or face value over the purchase price.[2]

Prior to the decision of this Court in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, the Board of Tax Appeals in a number of decisions held, con-

[2] Regulations 45, Article 544 (1) (c); Regulations 62, 65 and 69, Article 545 (3) (c); Regulations 74 and 77, Article 68 (1) (c).

trary to the regulations, that no taxable income is realized by a taxpayer upon the purchase of its bonds at less than their face value.[3] Subsequent to the *Kirby Lumber* decision in which this Court approved the Commissioner's regulations as a correct statement of the law, certain of the prior Board decisions holding that no taxable income was realized were reversed by the Circuit Courts of Appeals.[4] The Board of Tax Appeals has since followed the *Kirby Lumber* case in subsequent decisions.[5]

In the instant case the Board in its original opinion, promulgated before the decision in the *Kirby*

[3] See *e.g.*, *Independent Brewing Co. of Pittsburgh* v. *Commissioner*, 4 B.T.A. 870; *Houghton & Dutton Building Trust* v. *Commissioner*, 20 B.T.A. 591, and cases cited; *Rail Joint Co.* v. *Commissioner*, 22 B.T.A. 1277, affirmed 61 F. (2d) 751 (C.C.A. 2d:); *Terre Haute, Indianapolis & Eastern Traction Co.* v. *Commissioner*, 24 B.T.A. 197.

[4] *Kirby Lumber Co.* v. *Commissioner*, 19 B.T.A. 1046, reversed on stipulation of counsel, January 29, 1932 (C.C.A. 5th); *American Tobacco Co.* v. *Commissioner*, 20 B.T.A. 586, reversed on stipulation of counsel, January 21, 1932 (C.C.A. 2d); *Houghton & Dutton Building Trust* v. *Commissioner*, 20 B.T.A. 591, reversed per curiam December 21, 1931 (C.C.A. 1st); *Norfolk Southern Railroad Co.* v. *Commissioner*, 22 B.T.A. 302, reversed, 63 F. (2d) 304 (C.C.A. 4th); *Coastwise Transportation Corporation* v. *Commissioner*, 22 B.T.A. 373, reversed, 62 F. (2d) 332 (C.C.A. 1st).

[5] *Consolidated Gas Co.* v. *Commissioner*, 24 B.T.A. 901; *Woodward Iron Co.* v. *Commissioner*, 24 B.T.A. 1050; *Suncrest Lumber Co.* v. *Commissioner*, 25 B.T.A. 375; *Norfolk Southern Railroad Co.* v. *Commissioner*, 25 B.T.A. 925; *Garland Coal and Mining Co.* v. *Commissioner*, 28 B.T.A. 348.

Lumber case, held that the respondent realized no income by purchasing, at less than face, bonds of its predecessor and its own notes. Upon rehearing after the *Kirby Lumber* decision, the Board held, upon concession by the respondent, that taxable income was derived upon the repurchase of the notes, but declined to modify its decision with respect to the bonds on the ground that this liability had been assumed in connection with the purchase of capital assets and that the favorable retirement was merely a reduction in the purchase price of property which the respondent continued to own. Upon the same ground the Circuit Court of Appeals affirmed the Board's decision with respect to the retirement of the bonds.

We contend that the principle underlying the decision in the *Kirby Lumber* case applies irrespective of the nature of the property acquired and consequently that the decision below was erroneous.

II

THE PURCHASE AT LESS THAN FACE OF THE BONDS ASSUMED BY THE RESPONDENT RESULTED IN TAXABLE INCOME MEASURED BY THE DIFFERENCE BETWEEN THE FACE VALUE OF THE BONDS AND THE COST OF RETIREMENT

In *United States* v. *Kirby Lumber Co., supra,* the taxpayer had issued bonds for which it received their par value. Neither the opinion of this Court nor the findings of the Court of Claims (71 C.Cls. 290) disclose whether the payment for the bonds was in cash or other property. During the same

year the taxpayer repurchased some of the bonds at $137,521.30 less than par or face value. In holding that this amount constituted taxable income this Court said (284 U.S. 3):

> Here there was no shrinkage of assets and the taxpayer made a clear gain. As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here. * * *

The principle so stated is equally applicable here. At the time the respondent assumed the Sen Sen Chiclet Company's obligation on the bonds it acquired property of the latter company presumably equal in value to the obligation of the bonds which it assumed; at least there is nothing in the case to show that the property was worth less. No taxable income was derived at the time, since the property acquired was offset by equivalent obligations. But when in subsequent years the respondent purchased some of the bonds, at less than face then as a result of its dealings, it reduced its liabilities, and to the extent of the difference, increased its surplus free from the liability of the bonds now extinct. The proposition is simply that a reduction in liabilities may result in income as much as

an increase in assets. That is the proposition, we submit, which was decided in the *Kirby Lumber* case. The decision there was based not on the nature of the property acquired when the bonds were issued, but on the effect which their retirement had upon the financial situation of the obligor.

In *Maryland Casualty Co.* v. *United States,* 251 U.S. 342, this Court recognized that taxable gain may result from the release of assets to the general uses of the owner. While this Court refused to hold that the diminution of the reserve constituted income since it did not clearly appear that any portion of the reserve was released to the free use of the taxpayer during the taxable year, this Court said (p. 352):

> If, in this case, it were due to an overestimate of reserves for 1912 with a resulting excessive deduction for that year from gross income and if such excess was released to the general uses of the company and increased its free assets in 1913, to that extent it should very properly be treated as income in the year in which it became so available, for the reason that in that year, for the first time, it became free income, under the system for determining net income provided by the statute, and the fact that it came into the possession of the company in an earlier year in which it could be used only in a special manner, which permitted it to become non-

taxable would not prevent its being considered as received in 1913 for the purposes of taxation, within the meaning of the act.

The "reserve" in insurance computation is merely a particular kind of liability. When the Court in the *Maryland Casualty* case spoke of the excess of reserve being "released to the general uses of the company," what it referred to was simply a reduction in the liability item for reserves in the company's balance sheet during the year in question. By this reduction in liabilities, the company's net worth was increased, and this Court held that this increase was taxable income.

The courts have held in other cases that taxable income is realized in the year when corporate funds are considered to be free from contingent obligations and released to the general uses of the corporation. Cf. *Charleston & W. C. Ry. Co.* v. *Burnet,* 50 F. (2d) 342 (App.D.C.); *Chicago, R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. (2d) 990 (C.C.A. 7th), certiorari denied 284 U.S. 618; *Commissioner* v. *Langwell Real Estate Corporation,* 47 F. (2d) 841 (C.C.A. 7th). Here upon the purchase of the bonds the respondent's liabilities were reduced and its net worth was correspondingly increased over what it had been immediately before by the amount of the difference between the face value of the bonds and the retirement price. We contend that this constituted a real material gain to the respondent which was subject to tax in the year when the transaction occurred.

The decision below seems to be based upon the theory that since property rather than cash was acquired when the obligation was incurred, no taxable gain could be derived until the property originally acquired was disposed of. We submit there is no basis in reason for this theory. Income may arise from an increase in value of property on the one hand, which is taxable when realized by a sale or other disposition of the property. But taxable gain may likewise result, at least in the case of a solvent going concern, from the reduction of an obligation by the payment of a smaller amount, thereby increasing the excess of assets over liabilities. The gain here was not a growth or increment in value of the property acquired—such a gain would not be derived as income until the property itself is disposed of. The present gain resulted from the employment of the respondent's capital combined with its good fortune or skill in taking advantage of the opportunity of extinguishing a portion of its obligations before maturity by the expenditure of a lesser amount than the face of the obligations. It was a gain derived by the respondent from dealings in its obligations rather than its property.

In a somewhat similar situation, the regulations have consistently provided that the cancellation and forgiveness of indebtedness of a taxpayer gives rise to taxable income where such cancellation was not intended as a gift. Regulations 45, Article 51; Regulations 62, Article 50; Regulations 65 and 69,

Article 49; Regulations 74, Article 64. This we believe to be a correct construction of the law although in unusual cases, as where the debtor was insolvent, the courts have held that such cancellation does not result in taxable income. Cf. *Burnet* v. *John F. Campbell Co.*, 50 F. (2d) 487 (App.D.C.); *Commissioner* v. *Simmons Gin Co.*, 43 F. (2d) 327 (C.C.A. 10th). In the latter case the court indicated that the transaction might have resulted in a taxable gain had the corporation been solvent so that the release of the liability would have contributed to an excess of assets over liabilities. Where there has been no question of solvency it has been held that taxable income resulted. Cf. *Great No. Ry. Co.* v. *Lynch*, 292 Fed. 903 (Minn.); *B. F. Avery & Son, Inc.* v. *Commissioner*, 26 B.T.A. 1393.

There is no need for income tax purposes to consider as one indivisible transaction the acquisition of the property in return for the assumption of an obligation, the reduction of the obligation, and the subsequent sale of the property acquired, and thus compel taxation of the gain derived from the obligation to await the disposal of the property. In fact such considerations are opposed to the accepted method of determining taxable income. The income tax laws are based upon a system which considers the results of annual accounting periods rather than one which must await the final outcome of any given transaction. Only by such a system is

it practicable to produce a regular flow of income and apply methods of accounting, assessment and collection capable of practical operation. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 363–365; *Woolford Realty Co.* v. *Rose*, 286 U.S. 319, 326.

The principle that gain is determined upon the basis of annual accounting periods is plainly applicable here since there were in fact separate and independent transactions. In the first, property was acquired and its cost fixed by the amount of the obligations assumed in consideration therefor. The cost of the property was then determined as definitely as if the payment had been made in cash. Since the respondent's books were kept on the accrual basis (R. 13), there is no significant distinction between a payment made by decreasing assets on the one hand, or by increasing liabilities, as in this case. So far as the purchase of the property is concerned it was a completed transaction when the respondent assumed the liability represented by the bonds. The situation is indistinguishable from that in *Burnet* v. *S. & L. Building Corp.*, 288 U.S. 406, and *Lucas* v. *Schneider*, 47 F. (2d) 1006 (C.C.A. 6th), certiorari denied, 284 U.S. 622, where it was held that an existing mortgage assumed by a purchaser is to be included as part of the purchase price in finding the vendor's profit.

The cost of the property having thus been determined the question of gain or loss upon its disposition is a matter which has to do with future trans-

actions with that property and which bears no relation to future dealings in the bonds. The bonds were retired in subsequent years in a separate series of transactions between the respondent and persons other than the corporation from which the property was acquired. The question of gain or loss in subsequent dealings in the obligation incurred is a matter properly to be considered by itself with its own tax results, entirely apart from the ultimate disposition of the property originally acquired.

Since the gain here resulted from the respondent's dealings in its obligation there should be no need to consider the nature of the assets acquired when the obligation was incurred. But even if such consideration is given we believe it does not affect the fact that taxable income was derived. Income may be derived in the form of property as well as cash. *MacLaughlin* v. *Alliance Ins. Co.*, 286 U.S. 244, 249; *Lincoln Bank & Trust Co.* v. *Commissioner*, 51 F. (2d) 78 (C.C.A. 6th). It has been frequently held that where services are paid for in property the fair market value of the thing taken in payment is to be reported as income of the recipient. *Old Colony Trust Co.* v. *Commissioner*, 59 F. (2d) 168 (C.C.A. 1st); *F. G., Inc.*, v. *Commissioner*, 47 F. (2d) 541 (C.C.A. 7th); *Rodrigues* v. *Edwards*, 40 F. (2d) 408 (C.C.A. 2d). The regulations are to the same effect. Regulations 45, 62, 65, and 69, Article 33; Regulations 74 and 77, Article 53. If the respondent had received

assets of the Sen Sen Chiclet Company in payment for services taxable income would have resulted, measured by the fair market value of the property received, to the same extent as if payment had been made in money. The sole important factual distinction between the instant case and the *Kirby Lumber* case is that here the original increase in assets, offset by equivalent obligations, took the form of property instead of cash.[6] Since income may be derived in either form the distinction in facts can lead to no different result and the *Kirby Lumber* decision governs the case.

The sole decision which we have found directly in point, other than the decision of the court below, is that of the Circuit Court of Appeals for the First Circuit in *Commissioner* v. *Coastwise Transp. Corp.*, 62 F. (2d) 332. There the taxpayer issued serial notes in part payment of the purchase price of a fleet of ships. It subsequently retired the notes

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[6] We do not believe there can be any distinction in principle due to the fact that the respondent assumed the obligation rather than issuing it in the first instance, and the court below felt that this difference would not require a different result. (R. 29.) Furthermore, although the *Kirby Lumber* case dealt with a situation in which the bonds had been issued and purchased within the same year, it has been subsequently recognized that a case may fall within the purview of that decision although the bonds are purchased during a later year. *Norfolk So. Railroad Co.* v. *Commissioner*, *supra*; *Consolidated Gas Co. of Pittsburgh* v. *Commissioner*, *supra*; *Woodward Iron Co.* v. *Commissioner*, 24 B.T.A. 1050; *Suncrest Lumber Co.* v. *Commissioner*, *supra*.

at less than face value by purchases for cash and by the substitution of bonds. The Board held that no taxable income arose from the retirement of the notes. The Circuit Court of Appeals reversed the Board on the authority of the *Kirby Lumber* decision. While the opinion does not discuss the fact that property instead of cash was originally acquired, this fact clearly appeared in the court's statement of the case and was evidently considered insufficient to affect the applicability of the *Kirby Lumber* decision. Upon the taxpayer's insistence that because of losses suffered and depreciation of its assets there was no release of assets, or in the alternative that the transaction was in effect a reorganization, the court remanded the case to the Board to determine these facts. The Board has since taken additional testimony and has adhered to its previous decision on two grounds, (1) that there was no release of free assets and (2) that the case is governed by the decision of the court below in the instant case. The Commissioner has filed a new petition for review of the decision of the Board rendered on rehearing.

In *B. F. Avery & Son, Inc.*, v. *Commissioner*, 26 B.T.A. 1393, the Board of Tax Appeals has taken a position which we believe is inconsistent with its decision in the instant case. There the taxpayer purchased certain manufacturing equipment and finished products and gave its notes in part payment. Subsequently some of the notes were can-

celled by the seller because of defects in the property sold. The Board held that income was derived from the cancellation of the taxpayer's obligations, relying on the *Kirby Lumber* decision and the fact that the income tax laws are based on fixed annual accounting periods. The court below recognized that its decision in *Commissioner* v. *Rail Joint Co.*, 61 F. (2d) 751, has no application here and we agree that such is the case. There the taxpayer had acquired no property by the issue of its bonds which it subsequently retired so that there had been no increase in its assets at any time.

We believe that the decision of this Court in *Bowers* v. *Kerbaugh-Empire Co.*, 271 U.S. 170, was based on the peculiar facts of the case and cannot be taken to mean that in the usual situation the Government must await the sale of the assets acquired before taxing the gain realized by the favorable retirement of the obligation. In the *Kerbaugh-Empire* case the taxpayer had borrowed money repayable in marks and the money so borrowed had been lost before any repayment was made. Thus before the taxpayer had satisfied the obligation the assets had been wiped out leaving only a liability. Under the circumstances this Court felt that the mere diminution of the amount of the loss did not constitute taxable income. Since the consideration received had been lost in its entirety the taxpayer had neither made a profit on the transaction nor received any money or property which could have

been made subject to the tax. Cf. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 364.

In the present case, the assets received were not wiped out in advance of retirement of the obligation and the case does not present a situation in which there was nothing more than the diminution of a loss. The assets remained subject to the respondent's use and a clear gain was realized as a result of transactions between the respondent and the public, separate and distinct from that in which the assets were acquired. This Court has not shown a disposition to extend the doctrine of the *Kerbaugh-Empire* case beyond the particular situation presented (cf. *Burnet* v. *Sanford & Brooks Co., supra*) and we submit that it should not govern here.

The reasoning upon which the case was decided below, when followed to its logical conclusion, will engraft unwarranted limitations upon the accepted system of determining gain or loss on the result of annual transactions. If the cost of the property remains undetermined until the obligation is retired no gain or loss can be computed upon the sale of the property as long as the obligation remains outstanding. So if a corporation acquires the assets and assumes the liabilities of another and sells the assets in the following year but does not retire the obligations until twenty years thereafter, no gain or loss may be computed on the sale of the assets until twenty years after it has taken place. The same result would follow where property was

purchased partly for cash and partly by the issue or assumption of bonded indebtedness. Under similar reasoning, if property acquired by the assumption of the indebtedness is destroyed by fire or other casualty no deduction may be taken in the year when the loss was sustained since the cost of the property is still uncertain as long as the obligation is unsatisfied. Moreover, if cost remains undetermined there would be no proper basis for depreciation and kindred allowances. Again, where bonds issued for property are retired at a premium, the regulations have consistently provided that the amount of the premium is a deductible expense when paid. Regulations 45, Article 544 (1) (b); Regulations 62, 65, and 69, Article 545 (3) (b); Regulations 74 and 77, Article 68 (1) (b). This deduction should not be allowed if the amount of the premium is merely added cost of the property acquired.

These implications of the decision below demonstrate its unsoundness as a practical matter under a system taxing annual gain or income. We submit that the limitations it places on such a system are not required by a statute which taxes generally all gains from whatever source derived, and are not permissible under the regulations (*supra*, p. 2) which this Court expressly approved "as a correct statement of the law" in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, 3.

CONCLUSION

The case is ruled in principle by the decision of the *Kirby Lumber* case. The decision of the court below is erroneous and should be reversed.

Respectfully submitted.

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